# Fraud on a Power: the interface between contract and equity

## Lecture for the Chancery Bar Association

## Great Hall, Lincoln's Inn, London


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## 2 April 2019

How far can a legal instrument intended to have long-term effects control for the unknown future? This is a general problem for those acting in 'the now' with a view to regulating what happens to their property or personal obligations in the future. It is an issue which may arise across practically the whole range of legal instruments. It has implications for the interpretive and drafting techniques used in relation to statutes, contracts, wills and trust instruments, to name the most prominent cases.

It is difficult for those drafting a legal instrument intended to have effect far into the future to foresee how the relationships which it governs should be adjusted in the light of circumstances which might arise some way off in time. Speaking of statutes, which have to be made to work sensibly in situations not actively foreseen by the legislature, the German jurist Gustav Radbruch made this suggestive statement:

> "The interpreter may understand the law better than its creators understood it; the law may be *wiser* than its authors – indeed, it *must* be wiser than its authors."[2]

The recent re-affirmation of a fairly strict semantic approach to the interpretation of contracts in *Arnold v Britton*[3] and of the strictness of the test for implication of terms in the *Marks & Spencer*


[1] With thanks to Philippe Kuhn for his excellent research assistance.


[2] G. Radbruch, "Legal Philosophy", in *The Legal Philosophies of Lask, Radbruch and Dabin* (trans. K. Wilk, 1950), 141-142.

[3] [2015] UKSC 36; [2015] AC 1619. Also see *Wood v Capita Insurance Services Ltd* [2017] UKSC 24; [2017] AC 1173.

case[4] tends against interpretation as an approach to allow private legal instruments to be adjusted to accommodate the unforeseen future. The focus is on what the parties have said as the manifestation of their joint intention at an historic juncture when they made their agreement. The tendency under the interpretive approach set out in the *Investors Compensation Scheme* case[5] for contract terms to be construed with an emphasis on reasonable understanding, presumably judged in the light of the circumstances thrown up by the dispute in hand, has been curtailed. The more narrowly semantic approach provides a strong incentive and discipline for the parties to think through their positions and bargain expressly for what is important for them; to strive for reasonable certainty through their own efforts. The courts will not save them through a flexible approach to interpretation. But this in turn reduces the extent to which the contract can be *wiser* than its authors to respond to unforeseen changes of circumstances through an interpretive approach.

Against that doctrinal background, the drafters of contracts and other legal instruments have to use more explicit drafting techniques to create mechanisms which can allow for adjustment of a long term legal relationship to accommodate changing circumstances over time in a fair and acceptable way under the continuing umbrella of the relationship itself. Two main techniques stand out.

The first is to grant discretionary powers to some person to make binding decisions in the future with legal effects. The grant of such powers to one party to a contract may give rise to especially acute issues regarding legal control, to take account of conflicting legitimate interests under the contract.

The second technique is to impose some supervening and flexible obligation regarding future conduct, such as a duty to act in good faith or reasonably, to govern the extent to which opportunistic advantage can be taken of express rights when circumstances change in unexpected ways. The parties may in this way seek to secure some protection against abuse of rights. Fiduciary duties also work in this way.

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[4] *Marks & Spenser Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72; [2016] AC 742.

[5] *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896.

Both techniques have generated considerable recent interest in the field of contract law. Contract lawyers have become very interested regarding discretions created by contracts and how, if at all, they are to be subject to legal control. There has been something of a trend of reaching out for public law concepts and the public law notions of rationality and capriciousness as possible models for judicial control in this area. The *Socimer* case[6] and the *Braganza* case[7] are markers here.

However, there is also a strong counter-current which pushes back against this transplantation. It is pointed out that the circumstances of public law and the circumstances of contract law are very different. Public law imposes obligations which arise externally to the will of the actor, the content of which is informed by an outward facing requirement to act in the public interest in some shape or form. The remedy granted when there is a breach is typically to quash the decision and require the public authority to re-take it. This accords primacy of decision-making power to the body which has been charged with taking that decision. By contrast, in contracts the duties are generated by the will of the parties, not generated by some external requirement of law. A party is typically entitled to act in a selfish way, to pursue its own interests in opposition to the interests of the other party, subject only to any promise it has made to the contrary. Pursuit of self-interest in that context is rational, so it is much more difficult to identify legal constraints based on the idea of rationality. And remedies are typically in the form of damages rather than an order requiring reconsideration by the decision-maker designated in the contract; so a court ends up deciding how a discretionary power should or would have been exercised rather than the decision-maker designated in the contract.

As well as discussion of express terms of good faith in the cases, there has been a recent focus on the possibility of implying a term of good faith into long term, relational contracts, triggered by the judgment of Leggatt J (as he then was) in the *Yam Seng* case[8] and the reactions to it, both in favour and against the idea.

[6] *Socimer International Bank Ltd v Standard Chartered Bank Ltd* [2008] EWCA Civ 116; [2008] Bus. LR 1304.
[7] *Braganza v BP Shipping Ltd* [2015] UKSC 17; [2015] 1 WLR 1661. See Chris Himsworth, "Transplanting irrationality from public to private law: *Braganza v BP Shipping Ltd*" [2019] Edin LR 1.
[8] *Yam Seng Pte Ltd v International Trading Corp Ltd* [2013] EWHC 111 (QBD).

In some typical long term relational contracts, the implication of broadly equivalent terms as a matter of law has long been an established technique for accommodating the twists and turns of future events with reference to a contract established in 'the now'. I am thinking of the employee's duty of co-operation to promote his or her employer's projects as articulated in the *ASLEF (No. 2)* case[9] and the reciprocal implied duty on an employer to maintain trust and confidence in the employment relationship illustrated by cases such as *Malik v BCCI.*[10] The effect of these implied terms is to smooth out the application of express contractual rights when circumstances change, with a view to maintaining the ongoing viability and objects of the relationship within broadly agreed boundaries and for broadly agreed purposes. Employer and employee alike are constrained from opportunistic abuse of their express rights.

It is inherent in both the techniques I have mentioned that they involve some uncertainty as to how the contract will operate when circumstances change in future in what may be unpredictable ways. This is a conceptual point. The techniques are used in an attempt to allow for fair adaptation of contractual obligations in the context of future changes of circumstances. Sometimes it can be said that a term creating a discretion for a party to act in a particular way is used in a particular context to indicate an intention to demarcate an absolute right for that party, unconstrained by any obligation to have regard to or to protect the interests of the other party. However, outside such contexts, where the parties stipulate that one of them is to have a discretion, the more natural inference is that they have resorted to this as a mechanism to allow for reasonable adjustment of their relationship in the face of future changes of circumstances and that they intend there to be some constraint on the exercise of that discretion. But if the parties have not expressly stipulated what that constraint should be, how are the courts supposed to identify it?

In this lecture I want to make two suggestions. First, there is scope for identifying constraints on discretionary powers in relational contracts by reference to the idea of loyalty to the joint endeavour created by the contract. These constraints are inherent in the grant of the power, by reference to the purpose for which it has been granted. On this view, it is a category error to say that constraints can only be said to arise if the very demanding test for implication of terms is satisfied for the putative constraint in question. That is why I find the equitable notion of "fraud

[9] *Secretary of State for Employment v ASLEF No. 2* [1972] 2 QB 455.
[10] *Malik v BCCI* [1998] AC 20.

on a power" so interesting and instructive. The decision of the Supreme Court in the *Eclairs Group* case[11] provides a recent example of its application. In the context of private law, Equity has been looking at this sort of issue for much longer than the common law. It may offer a more satisfying way forward for contract than the public law analogies drawn from the *Wednesbury* case[12] which are so much in vogue at the moment.

Secondly, however, I want to suggest that it is becoming difficult to sustain a conception of the equitable doctrine of "fraud on a power" as something distinct from the will of the parties in a contractual context, or as distinct from the will of the testator or the settlor of a trust, as expressed in the relevant legal instrument in each case. The doctrine was originally conceived, as so many equitable doctrines were, as something laid over the top of rights defined in law or a legal instrument, and imposing distinct norms of conduct from outside. But I think that now there is a strong case for saying that the doctrine should be taken to be more directly informed by what the parties have stipulated in their contract, or in a will or trust instrument, as the case may be. In this lecture I want to focus on contracts.

The upshot of my two themes this evening is that contract doctrine should draw on the resources of equitable doctrine, but also that equitable doctrine should be moulded around contractual rights. I will argue that the time has come for them to meet in the middle. After looking at some of the equity cases I will also return to the analogy with public law, and suggest that we may be looking in the wrong place by focusing on the *Wednesbury* case. Perhaps it is the *Padfield* decision,[13] in which limits on the use of discretionary power were drawn from an analysis of the purpose of the statute on its proper construction, which may provide the better analogy.

Sometimes it is said that the problems associated with long term relational contracts are new. But they are not. A lease is a long term contract with relational aspects, and the drafting technique of saying that landlord consent for change is not to be unreasonably withheld is familiar. More germane for this evening, Equity has of course been grappling for a long time with the issues posed by discretionary powers created to allow for adjustment to future events. Settlement trusts

[11] *Eclairs Group Ltd v JKX Oil and Gas Plc* [2015] UKSC 71.
[12] *Associated Provincial Picture Houses Ltd v Wednesbury Corp.* [1948] 1 KB 223.
[13] *Padfield v Minister of Agriculture, Fisheries and Food* [1968] AC 997.

of property were specifically created in 'the now' to allow for, at the same time as constraining, management of family property far into the future.

I want to develop my argument this evening by tracing the development of the doctrine of fraud on a power from an aspect of equity – something distinct from and laid over the top of interpretation of instruments in law - into something which looks increasingly like an aspect of the interpretation of contracts and other legal instruments.

The case of *Duke of Portland v Topham*[14] from 1864 concerned a power to appoint a fund to either or both of the settlor's daughters. The donee of the power executed a deed of appointment which in form gave the whole of the fund to one of the daughters, but this was done pursuant to an arrangement whereby she would only take half the fund for her own use with the other half being invested in the name of the donee, herself and her brother, to accumulate and be distributed as they saw fit later on. The appointment was set aside for fraud on the power. Lord Westbury LC explained the operation of the doctrine thus:

> *"…the donee, the appointor under the power, shall, at the time of the exercise of that power, and for any purpose for which it is used, act with good faith and sincerity, and with an entire and single view to the real purpose and object of the power, and not for the purpose of accomplishing or carrying into effect any bye or sinister object (I mean sinister in the sense of its being beyond the purpose and intent of the power) which he may desire to effect in the exercise of the power*."

The old equity books contain many examples of this doctrine in action.[15] One from the early part of the twentieth century is *Clouette v Storey*,[16] in which an appointment was made by a father to one of his children pursuant to a power in a trust instrument, but subject to a covert arrangement that fruits of the appointment would be returned to the father who was the donee of the power of appointment. In *Clouette* the Court of Appeal stated that the effect of fraud on a power is that a disposition made in consequence is void rather than voidable; but this was

[14] 11 HLC 32.
[15] See *Eclairs* at [12]-[13]; *Story on Equity* (3rd ed. 1920), 105-106; *Farwell on Powers* (3rd ed. 1916) 457ff; *Sugden on Powers* (8th ed. 1861) 606ff.
[16] [1911] 1 Ch 18 (CA)

questioned by Lord Walker in *Pitt v Holt*[17]. I will return to this issue later on. For the moment, I note that it is cases of this character which gave the equitable doctrine its name. As Lord St Leonards put it in *Sugden on Powers* in 1861[18]:

> *"There are some cases which a court of law cannot reach. This happens where the power is duly executed according to the terms of it; but there is some bargain behind, or some ill motive, which renders the execution fraudulent, and will enable equity to relieve."*

But he noted a strand in the old cases which raised the question, *"where the execution is altogether a fraud on the power, it may be asked, why, if you can once attack a deed executed under a power on the ground of fraud, may not that fraud be established at law as well as in equity?"*

Lord St Leonard's discussion exposes a distinction between cases in this field. A power creating a discretion to make an appointment might be clear on its face as to its objects or the purposes to be pursued. The person exercising the power would act in excess of that power if she ignored those express limits. If the power said she could appoint property to A, B or C, she would act outwith the power if she appointed to Z. This would be a *patent* incorrect use of the power. Lord St Leonard noted that the common law could detect this and respond to it.

On the other hand, the donee of the power might act in a covert and clandestine way to subvert the intended use of the power. This would be a *latent* incorrect use of the power. It is this type of case which looks more fraud-like and which more obviously in the early cases called for the intervention of equity.

The next important landmark is the speech of Lord Parker of Waddington in *Vatcher v Paull* in 1915.[19] Lord Parker took the notion of a fraud on a power, but, emphasising the proper

[17] [2013] 2 AC 108, [62]
[18] 8th ed., 606.
[19] [1915] AC 372, esp. at 378.

purposes strand of reasoning in cases like *Topham*, articulated the doctrine in a way which covers both patent and latent improper purposes:

> "*The term fraud in connection with fraud on a power does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term or any conduct which could be properly termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of or not justified by the instrument creating the power*."

He described the paradigm case of fraud on a power as one where *"the appointor's purpose and intention is to secure a benefit for himself, or some other person not an object of the power."*

In Lord Parker's formulation of the principle one has come closer to treating it as an aspect of interpretation of the legal instrument itself. How is one to tell what is the scope of the power which is being exercised or for what purposes it might be exercised if ***not*** through interpretation of the instrument itself? This leads to this question: in cases where the instrument does not itself spell out expressly for what purposes the power may be used, how should those purposes be identified and how does one tell when they are outside the scope of the power?

However, in the *Eclairs* case Lord Sumption was at pains to say that the proper purpose rule inherent in the doctrine of fraud on a power and replicated in section 171(b) of the Companies Act 2006 *"is **not** concerned with excess of power by doing an act which is beyond the scope of the instrument creating it as a matter of construction or implication"*, but rather with *"abuse of power, by doing acts which are within its scope but done for an improper reason"* ([15]). What is one to make of this? Why doesn't the instrument itself control the reasons for acting which are proper or improper, as a function of its interpretation?

The case concerned the exercise of powers conferred on the directors of a public limited company by its articles of association, which constitute a contract binding on the members. The directors were concerned to block what they saw as a possible attempt by minority shareholders to take control of the company by way of a corporate raid to be effected by requisitioning an

extraordinary general meeting to vote in changes to the board of directors. The particular power in question was a power to restrict the exercise of rights attaching to shares where those interested in the shares had failed to comply with disclosure notices requiring them to explain the beneficial ownership of the shares by reference to which the EGM had been requisitioned and whether there was any arrangement between the owners of those shares to act in concert. Non-compliance with the disclosure notices enabled the Board to issue a restriction notice which had the effect of disenfranchising the owners of the shares in relation to voting at a subsequent AGM held by the company.

The Supreme Court held that the directors acted for an improper purpose and that the restriction imposed on the voting rights of the shareholders was invalid. The case contains a highly interesting discussion of the question, where directors have mixed purposes, whether the test for invalidity of their exercise of the power is that the improper purpose was the weightiest or primary purpose for which they acted or whether a 'but for' test applies, i.e. that but for the improper purpose a different decision would have been taken. There was a difference of views about that between Lord Sumption and Lord Mance.[20] But it is not that aspect of the case on which I wish to dwell, but the question of the relationship between the doctrine of fraud on a power and the interpretation of the articles of association.

Lord Sumption returned to his view that the two are distinct at para. [30] of his judgment, which is worth quoting in full:

> *"The submission of Mr Swainston QC, who appeared for the company, was that where the purpose of a power was not expressed by the instrument creating it, there was no limitation on its exercise save such as could be implied on the principles which would justify the implication of a term. In particular, the implication would have to be necessary to its efficacy. In my view, this submission misunderstands the way in which purpose comes into questions of this kind. It is true that a company's articles are part of the contract of association, to which successive shareholders accede on becoming members of the company. I do not doubt that a term limiting the exercise of powers conferred on the directors to their proper purpose may sometimes be implied on the ordinary principles of the law of contract governing the implication of terms.*

[20] See further on this, *Stobart Group Ltd v Tinkler* [2019] EWHC 258 (Comm), [426]-[452].

*But that is not the basis of the proper purpose rule. The rule is not a term of the contract and does not necessarily depend on any limitation on the scope of the power as a matter of construction. The proper purpose rule is a principle by which equity controls the exercise of a fiduciary's powers in respects which are not, or not necessarily, determined by the instrument. Ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context."*

Two points should be emphasised here. First, Lord Sumption was concerned to reject the idea that the only constraints on the exercise of the power had to be derived, if at all, from the very restrictive test for implication of terms in a contract or other instrument. That is a very important point and I respectfully think it must be correct. But secondly, again respectfully, I do wonder whether Lord Sumption is right to say that an analysis of the purpose of the power is a matter to be determined as something distinct from its proper interpretation. Might it not be said that the matters referred to by Lord Sumption as relevant to the identification of the proper purposes for which the power might be exercised – inferring the mischief or object at which the power is directed from the express terms, business context and the practical effects which its exercise in a given context will bring about – are precisely the matters to which one would have regard when interpreting the limits inherent in the power in the contractual setting in which it appears?

Where a wide contractual power of this kind is created, it seems a natural inference that the parties intended it should be used for proper purposes within the scope of what the parties contemplated would be acceptable in the context of their on-going relationship. The power contains these limits within itself; so it is not relevant to apply the restrictive test for implication of terms. Lord Sumption was rightly concerned to reject that as the relevant test; but it seems to me to be arguable that in seeking to achieve this he did not need to reject the idea that identifying the proper purposes for which the power might be used was a function of interpretation of the contract.

Perhaps it would be more fruitful to look at problems of this kind in the manner adopted by the House of Lords in *Hole v Garnsey* in 1930.[21] In that case the rules of an industrial and provident society – equivalent to the articles of association of a company – contained a general discretionary power in rule 64 allowing for them to be amended upon a vote by a super-majority of the members. This power was exercised to alter the rules so as to require members of the society to subscribe for additional shares, as a way of raising funds for the society. The amendment to the rules was struck down as unlawful as being outwith the power of amendment, according to its proper interpretation. The result was arrived at without reference to equity or any distinct doctrine of fraud on a power.

Lord Atkin said:[22]

> *"I should have thought on principle that the matter was fairly plain. If a man enters into association with others for a business venture he commits himself to be bound by the decision of the majority of his associates on matters within the contemplated scope of the venture. But outside that scope he remains dominus and cannot be bound against his will."*

Although the power was in general terms, a decision to use it to raise additional capital for the company was outwith what the members contemplated when they joined the society. Lord Atkin illustrated the general approach with limits to be found on discretionary powers exercised in the context of partnership agreements.

> *"Amongst the matters in respect of which the individual does not agree to be bound in invitum appear to me to be the purposes of the association, and the amount of money which he will contribute to his associates for those purposes. I am not, of course, dealing with liability to third parties. These matters, generally speaking, I regard as fundamental. And unless there is reasonably clear indication in contractual terms, or statutory provisions that the individual member is to be bound in these respects against his will, his right to remain unaffected will continue."*

[21] [1930] AC 472.
[22] pp. 493-494

Lord Atkin also agreed with the speech of Lord Tomlin. Lord Tomlin identified the relevant question as *"whether, having regard to the general principles governing contracts inter partes, the amendments are effective as against members who have not assented to them."*[23]

He went on:[24]

> *"In construing such a power as this, it must, I think, be confined to such amendments as can reasonably be considered to have been within the contemplation of the parties when the contract was made, having regard to the nature and circumstances of the contract. I do not base this conclusion upon any narrow construction of the word "amend" in Rule 64, but upon a broad general principle applicable to all such powers".*
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> *"I do not think that it is within the contemplation of the parties to a bargain of this kind that they should be made liable for a compulsory levy or expenditure over and above the contributions payable or to become payable under the original terms. On the contrary I think the basis of such a bargain is that the extent of the member's liability is limited by the original terms and that it cannot be enlarged by any amendment of the rules."*

Viscount Sumner's speech was to the same effect. To support a claim that the power in rule 64 should be construed as including a power to impose these substantial new financial burdens on members of the society "*either clear judicial authority, clear legislation or clear principle and necessity would seem to be required*"; but none of these was present.[25] This is almost the reverse of the test for the implication of terms: one construes the power as being presumptively subject to fundamental limits derived from the basic nature of the joint endeavour, and treats those as abrogated only if there are very clear indications to that effect.

Lord Dunedin likewise considered the power in rule 64 did not extend to allow this change to the rules, which was "*an alteration … which did not simply affect the rights of the member in the capital of the Society, but imposed a perfectly new and outside liability upon him*."[26]

[23] p. 500
[24] p. 501
[25] p. 491.
[26] p. 490.

On this approach to analysing how to construe the ambit of a contractual power, one has to stand back from the mere language of the power-conferring provision, which may be entirely general. It is necessary instead to form a broad view of the purposes of the venture to which the contract gives effect, and of what loyalty to that venture might involve for a party to it, and to take those broad purposes as providing the inherent limits for the exercise of the power. Those limits will constrain the due exercise of the power whether the illegitimate purpose for which it is exercised is patent at the time of the exercise or is latent.

It might be said that this seems a rather vague test for the limits of a discretionary power. But the vagueness does not mean that the limits are content-less; nor that there is an absence of a methodology for working out in a particular case where the limits lie. That can be done having regard to the nature of the venture, the other contractual terms and what is sought to be achieved by the exercise of the power. In fact, the vagueness is just a reflection of the situation the parties find themselves in when they contract, in which they cannot predict future circumstances but wish to make provision for their relationship to be capable of continuance into the future including by adjustment to future events via the exercise of discretionary powers created for that very purpose. If the court can discern the broad outlines of what the parties contemplated such powers could or should be used for and can tell when a purported exercise lies outside such contemplation, I do not see why as a matter of contractual interpretation the court cannot say that the use of the power exceeds those contractual powers.

On this approach, there is no need to overlay a distinct equitable principle called 'fraud on a power'. It is also difficult to justify having resort to such a principle. If exercise of a power is within the contemplation of the parties to the contract, what business has equity in intervening to defeat their expectations? Perhaps the better view is that we should recognise that on a modern approach to the relationship between law and equity and to the interpretation of discretionary powers, the principles for the interpretation of the ambit of a power are really in substance the same as would have governed the old rules delimiting the operation of the fraud on a power doctrine. On a common law approach which is less rigid and reified than it was in the eighteenth or nineteenth centuries, there is less need for a distinct body of equitable doctrine laid over the common law to moderate its effects and provide protection against abuse of the rights it otherwise seemed to lay down.

It can be argued that this approach to the interpretation of broad discretionary powers in contract, as having internal limits rather than limits which have to be found by implication of additional terms, marries up with important strands in the modern law on contract interpretation. In *Schuler v Wickman*[27] Lord Reid observed that the more an interpretation leads to a result contrary to business sense, the more the court would lean against it. In *Modern Engineering v Gilbert-Ash*[28] Lord Diplock held that there is an interpretive presumption against the removal of common law remedies. In *Photo Production v Securicor*[29] he identified a similar interpretive presumption against the removal of the rights associated with the ordinary remedial consequences of breach of contract. These cases show that generally the presumed limits inherent in a contractual provision are generated by the parties themselves, by reference to how they frame the primary obligations in the contract and what can be taken to be expected in the particular business context. Sometimes, the normative force of those expectations is reinforced by policies reflected in the common law, as in the *Gilbert-Ash* case and as with the very strong presumption, which may be irrebuttable in some circumstances, against exclusion of remedies for fraud or bad faith.[30] Notice how closely this resembles the old core idea in equity of fraud on a power.

The approach can also be said to mesh with other ideas in the law of contract regarding limitations found to be inherent in contractual rights themselves, in relation to remoteness of loss. Rules regarding remoteness of loss are themselves a legal technique for moderating the effect of contractual rights in the light of the arrival of future events which were outside the contemplation of the parties at the time of contracting. The two limbs of the rule in *Hadley v Baxendale*[31] which set out the principles according to which the defaulting party will be held to be bound to make reparation in relation to loss arising from unfolding events both focus on the contemplation of the parties. In the *SAAMCO* case[32] and in *The Achilleas*,[33] Lord Hoffmann used an analysis based on limitations identified as inherent in the very duties assumed by the parties under a contract to control for the extent to which the defaulting party could be taken to have

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[27] *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235
[28] *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* [1974] AC 689, at 717
[29] *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, 850-851.
[30] *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 2 Lloyd's Rep 61.
[31] (1854) 9 Exch 341.
[32] *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191.
[33] *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2008] UKHL 48; [2009] 1 AC 61. See the discussion in David Foxton, "How useful is Lord Diplock's distinction between primary and secondary obligations in contract?" (2019) 135 LQR 249.

assumed responsibility for an unexpected detrimental turn of events later on. These cases may be controversial in their effect. But they illustrate the viability of a legal technique to find inherent limitations in contractual powers or rights without the need to identify separate and distinct implied terms.

The approach I have suggested also has a strong analogy in the public law context, in the shape of the so-called principle of legality. According to that principle, general discretionary powers in statute are read down so as not to encompass executive action which conflicts with human rights[34] or with fundamental constitutional principles such as the principle against retroactive effect of law and the ability to have access to a court.[35] In the context of a contract, it is the parties themselves who - in the way I have described and sometimes with some reinforcement from the general background law – generate the fundamental principles which underlie their joint endeavour which allow for the same basic legal technique to be used. It is the broad parameters within which the parties contemplated the discretionary power might be used in an uncertain future which constitute the fundamental limits inherent in the power itself.

As I mentioned previously, the public law case which seems perhaps most telling as an analogy is the *Padfield* case.[36] A statute set up a milk marketing scheme and provided for a Minister to have a discretionary power to appoint a committee of investigation regarding any complaint about the operation of the scheme, with a further power, if a committee reported there was a problem, to change the terms under which milk producers sold their milk under the scheme to the Milk Marketing Board. Prices had been fixed to include due allowance for transport costs, but over time these had changed. One regional association of producers who were particularly badly affected contended there should be a change in the price differentials across all the regions to reflect this, but had no support for this from the other regions who would be detrimentally affected by the change sought; hence the terms could not be changed by collective action by all the regional associations and the only option available was to ask the Minister to appoint a committee of investigation. The Minister exercised his discretion by declining to do so. The House of Lords held that an order of mandamus would issue to compel him to appoint a

[34] See e.g. *R v Secretary of State for the Home Department, ex p. Simms* [2000] 2 AC 115, 131-132 per Lord Hoffmann.
[35] See e.g. *Anisminic Ltd v Foreign Compensation Commission* [1969] 2 AC 147. See P. Sales, "A Comparison of the Principle of Legality and Section 3 of the Human Rights Act 1998" (2009) 125 LQR 598.
[36] See the speech of Lord Cooke of Thornden in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408.

committee. It held that Parliament had conferred a discretion on the Minister which was to be used to promote the policy and objects of the Act, which were to be determined by the construction of the Act. The Minister's discretion was not be taken to be unlimited, and since it appeared that the effect of his refusal to appoint a committee of investigation was to frustrate the policy of the Act, the court could interfere.

This is one of the classic leading cases in public law. What is significant about it for our purposes is that the House of Lords derived the inherent limitations, or guiding principles, governing the exercise of the Minister's discretion from the scheme of the Act as a whole. The limits were not found in the general legal or constitutional background, as with the cases on the principle of legality. The exercise of identifying limits to a discretionary power in *Padfield* seems to me to be closely similar to that undertaken in the "fraud on a power" cases in a contractual setting. It is also significant that in *Padfield* the limits were identified by means of an exercise of construction of the instrument itself – the Act – in its particular commercial setting. There is no reason why the interpretation of a contract should not proceed in the same way.

I think that this basic picture potentially provides a good framework for understanding modern caselaw on misuse of discretionary contractual powers in a corporate setting, with possible scope for being extended more widely. I have already remarked upon how closely Lord Sumption's reasoning in the *Eclairs* case seems to chime with this sort of approach.

The same is true for the decision of the Privy Council in *Howard Smith v Ampol Petroleum*.[37] In that case the directors of a company exercised a wide discretionary power contained in the articles of association to allot shares to one existing shareholder in order both to raise capital but also, critically, to boost the proportion of the company owned by that shareholder to enable it to make an effective takeover bid for the company. It was held that this action was for an improper purpose falling outside the scope of the discretionary power, and the allotment was set aside. As Lord Wilberforce held, in giving the advice of the Privy Council, to use the power to alter a majority shareholding was to interfere with that element of the company's constitution which was separate from and set against the directors' powers. He identified inherent limits to the

[37] [1974] AC 821.

power derived from the corporate constitutional environment established by the articles of association. Although the allotment of shares appeared to fall within the scope of the power – as Lord Wilberforce said, "*the issue was clearly intra vires the directors*" – nonetheless, as he put it, "*the directors' power under this article is a fiduciary power: and it remains the case that an exercise of such a power though formally valid, may be attacked on the ground that it was not exercised for the purpose for which it was granted*".[38] I would question whether describing the power as a fiduciary power does much significant normative work in this context, other than to emphasise that there are inherent limitations regarding its exercise which are to be found in the particular contractual context in which it is located.

As Lord Wilberforce went on, "*it is necessary to start with a consideration of the power whose exercise is in question … Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not*".[39]

Increasingly it is recognised that, in contexts governed by a contract, equitable principles have to take account of and fall to be moulded around the rights and obligations set out in the contract, as properly construed. This statement by Mason J in the High Court in Australia in *Hospital Products Ltd. v. United States Surgical Corporation*[40] has been influential:

> *"That contractual and fiduciary relationships may co-exist between the same parties has never been doubted. Indeed, the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be*

[38] p. 834.
[39] p. 835.
[40] (1984) 156 C.L.R. 41, 97. For example, Lord Browne-Wilkinson cited it in *Kelly v Cooper Associates* [1993] AC 205, PC, 214-215; *Ranson v Customer Systems Plc* [2012] EWCA Civ 841, [25]-[26] per Lewison LJ.

*superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction.*"

The thrust of my argument this evening is that on a proper approach to contractual interpretation, informed by the lessons drawn from the equitable concept of "fraud on a power", perhaps one does not need to look beyond the contract itself to locate the limits on a discretionary power.

Before cheerfully finishing off on that triumphant note, however, and telling a room full of equity lawyers that equity in this area should be consigned to the dustbin of history, I must inject a note of caution. If the law is to go down this route, it needs to do so with a more sophisticated and nuanced approach to the question of relief. Relief may be straightforward if it is easy to undo what has been done as a result of the improper exercise of a discretionary power; as, on the facts, was the case in *Eclairs* and *Howard Smith v Ampol*. But what if, as a result of the improper exercise of discretion, there has been a disposition of property to someone and they have spent it or used it in a way which makes simple restoration impossible, or they have acted to their detriment on the faith that it became their property without qualification; or, without receiving any property, a person has acted to their detriment in some other way in reliance upon their understanding that the exercise of discretion was valid?

One possible argument for continuing to distinguish between interpretation of a contract or other legal instrument and rules of equity laid on top is that the remedial position in equity might be more flexible. However, two points may be made about that.

First, of course equity protects equity's darling where there has been an acquisition of the legal estate in property for value without notice. But often value is not given for property transferred as a result of an exercise of discretion. In such situations equity has thus far painted itself into a corner, in that the Court of Appeal in *Clouette v Storey* has held that a disposition made in fraud of a power is void rather than voidable. On a conventional view, it is only if the disposition is categorised as voidable that there is scope for the operation of other equitable doctrines such as laches, acquiescence and so forth which protect the interest of the recipient if they have changed

their position. But it might be said that Lord Walker gave a broad hint in *Pitt v Holt* that the decision in *Clouette v Storey* is ripe to be overturned on this point.[41]

Secondly, however, it is open to doubt that this really is a good or a fair way forward. Of course, the contrast between decisions in excess of power, which might be thought of as void, and decisions within power but taken for improper purposes, which might be thought of as voidable, has deep roots in the cases. It also has echoes in other areas of the law, in particular in the distinction emphasised by the Court of Appeal in the *Rolled Steel* case[42] between acts which are ultra vires a company, in the sense of being outwith its memorandum of association, a public document, and the acts which are apparently within the company's powers but are beyond the authority of the directors under its articles of association. In relation to the latter type of case, the person dealing with the company may or may not be on notice of the problem. If he is not on notice, a person dealing with the company has protection from the principle in *Turquand's* case[43].

However, it may be argued that in the context I am addressing this evening, a simple divide between excess of power and exercise of discretion within power but for an improper purpose breaks down as a sound guide to remedial response. That is so for conceptual reasons, in that exercise of a discretion for an improper purpose is itself an action taken in excess of power. That, at any rate, is the position arrived at in public law and it seems sound. Still more importantly, that simple divide does not cater well as a principle of accommodation between the two interests which are in tension in these sorts of case: that is to say, between a desire to respect and give effect to the intention of the creator of the instrument in question (be it Parliament, the contracting parties, a settlor of a trust or a testator), on the one hand, and the interest of a recipient of property in security of receipt or the reasonable reliance interest of a person who acts in good faith on the basis of an apparently valid exercise of discretion. An exercise of discretion may be in excess of power in the old sense without the good faith recipient or person acting in reliance having any real opportunity of knowing that, by contrast with a person dealing with a limited company who has the opportunity to look at its memorandum of association if there is doubt. On the other hand, an exercise of discretion may be within power but for an improper purpose, in the old sense, where the recipient or person acting in reliance should have

[41] See also *Stobart Group Ltd v Tinkler* [2019] EWHC 258 (Comm), [453]-[488].
[42] *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246
[43] *Royal British Bank v Turquand* (1856) 6 E&B 327.

appreciated that. One might think that modern doctrine should move in the direction of protecting the recipient or person acting in reliance in the first case but not in the second, on a fair approach to balancing the interests in issue.

So perhaps we should be moving more explicitly to a principle in *both* these categories of case akin to that in *Turquand*'s case, i.e. of protection in the case of a person receiving or relying in good faith and without notice of the problem; and of no protection in the case of a person receiving or relying where they do not act in good faith or they have notice of the problem. However that may be, I suggest that we should treat the basic problem to be confronted - to resolve this tension in a principled, coherent and fair way - as the same whether one conceives the relevant legal framework to be the common law or equity or a mixture of both.

This is a huge topic all on its own, and I cannot develop these thoughts this evening. What I would say, however, is that the common law has shown it is capable of recognising appropriate defences to accommodate and resolve this kind of tension, through its development of the defence of good faith change of position in the law of unjust enrichment. Could that development be extended in a principled way into this cognate area?

Also, in one particular way, public law points towards a possible way forward. In the *Soneji* case[44] the House of Lords was confronted with a situation in which confiscation orders had been made by a judge in criminal proceedings, but too late according to the statutory scheme, after an inadvertent procedural failure. The individuals subject to the orders claimed that the orders made were ultra vires and void. It was also too late to start again and make new orders. The House of Lords refused to quash the orders, even though they had been made in excess of power. It expressed dissatisfaction with the old, rigid and artificial divide in public law between breach of mandatory procedural requirements (said to lead to a decision which is void) and breach of directory requirements (which do not have that effect), and preferred to adopt a new and more modulated approach, drawing on a dictum by Lord Hailsham in *London & Clydeside Estates v Aberdeen District Council.*[45] The House held that the correct approach to an alleged failure to comply with the doing of some act before a power was exercised was to ask whether it was the

[44] *R v Soneji* [2005] UKHL 49; [2006] 1 AC 340
[45] [1980] 1 WLR 182, 189-190.

intention of the legislature that an act done in breach of that provision should be invalid. In the context of that case, the answer was 'no': the judge's failure to adhere to the procedural provisions had not prejudiced the individuals as regards the criminal sentences they received, and any other prejudice caused to them by the delay was outweighed by the public interest in not allowing convicted offenders to escape confiscation for bona fide errors in the judicial process; hence the failure of process in issue could not have been intended by Parliament to invalidate the confiscation proceedings and the orders made.

Note how the Appellate Committee built the ability to moderate the extent of relief available in respect of action in excess of power into its interpretation of the power-conferring provisions. This looks a bit like what happens with decisions on remoteness of damage in contract law, as illustrated by the *SAAMCO* case and others I have referred to. I think the approach developed in *Soneji* regarding the interpretation of discretionary powers in statute may provide an interesting and potentially helpful way forward as an approach to the interpretation of discretionary powers in contracts, and may be in other instruments as well.

I therefore close my lecture by trying to leave you in a state of what Keats called "wild surmise" about what this vista of adjustment of the law of remedies might involve.

Thank you.